

SUBJECT: Israel: Political and Economic Conditions

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DIRECTORATE OF INTELLIGENCE

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ISRAEL: Political and Economic Conditions

Summary

With only five months remaining in Prime Minister Peres's tenure in office, he seems likely to honor his agreement to hand power over to Foreign Minister Shamir in mid-October despite strains that will plague the coalition. Peres nonetheless will keep a close eye on the leadership crisis in Shamir's Likud bloc, which could flare up at any time before the premiership changes hands and could precipitate the breakup of the coalition. Peres will be reluctant to exploit Likud's leadership problems, however, unless they fully discredit Shamir and swing public opinion in support of breaking up the unity government. []

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Despite the political frictions within the unity coalition, it has made significant progress on Israel's massive economic problems since introducing a new austerity program in July 1985. Inflation has cooled considerably, the exchange rate has remained relatively stable, and foreign exchange reserves have been rebuilt to a healthy level. In return for these gains, real wages inevitably have declined, and unemployment is growing. []

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The public has accepted austerity with equanimity in exchange for unaccustomed relief from inflation and generally approves of the government's handling of the economy to date. Problems could reappear, however, if the government permits the budget deficit to grow through extraordinary spending designed to relieve some

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[redacted]

of the pressures or if the political situation tempts the political parties to back off on austerity to woo votes in an early election. [redacted]

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Peres continues to be the most popular political figure in Israel. Recent public opinion polls indicate Peres's popularity has reached higher levels than any previous prime minister--nearly 68 percent of the Israeli public approves of his performance as prime minister. The polls also indicate that nearly two-thirds of the public currently favors preserving the Labor-Likud partnership. [redacted]

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Peres's political standing in the Labor Party also has risen substantially since assuming the premiership. After years of bitter feuding with Defense Minister Rabin, Peres has emerged as the unchallenged leader of his party. The applause that was reserved for him at Labor's national convention last month demonstrated his strong support and even led to a few complaints of an "excessive personality cult." Rabin clearly is the second leading figure in the party. [redacted]

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Some Labor Party activists are discontented, however, over Peres's unwillingness to break the rotation agreement with Shamir. Peres disappointed them when he failed to exploit the coalition crisis last month over the dismissal of Yitzhak Moday from the finance portfolio to break up the government. Peres agreed to allow Moday to remain in the Cabinet as Justice Minister in return for Shamir's verbal pledge that Moday's replacement, former Justice Minister Nissim, would be finance minister for the duration of the unity government. [redacted]

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Shamir's Tenuous Hold on Likud

In contrast to Peres's popularity as party and national leader, Shamir's public standing is low, and he maintains only a shaky hold on the leadership of Likud and its dominant component, the Herut Party. Shamir has relied on the support of Herut veterans and former Defense Minister Arens to outmaneuver his rivals--Deputy Premier Levy and Commerce Minister Sharon. Arens, who lacks strong factional support in the party, is nonetheless respected because of his reputation for honesty and integrity. He probably hopes that his alliance with Shamir will strengthen his candidacy if he decides to contest Levy and Sharon for the party leadership after Shamir retires. [redacted]

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[] Shamir's [] leadership was manifested at Herut's national convention in early March, which ended prematurely in disarray amid fisticuffs among delegates and disagreement among the leadership rivals about how to proceed. Shamir's credibility as party leader was damaged further during the crisis over Moday's departure from Finance when he was forced to back down from his threat to resign from the government so as not to jeopardize his chances of becoming Prime Minister. [] 25X6

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Outlook for the Unity Government

Having chosen not to use the Moday crisis as a pretext to break up the unity coalition, Peres now seems likely to honor the rotation agreement unless Likud makes a serious blunder. We expect further strains, however, to plague the coalition as the October rotation nears. Labor Party activists, disappointed with Peres's unwillingness to break the rotation agreement, will probably try to undermine the Labor-Likud partnership. Their efforts ironically are likely to be aided by Levy, whose interest in replacing Shamir as Likud leader would best be served by the dissolution of the current government and an early election. [] 25X1

[] Peres will closely watch the internecine warfare in Likud, but he probably would not try to exploit Likud's leadership crisis unless it discredits Shamir and swings public opinion in support of breaking up the unity coalition. Shamir will strive to ignore Labor provocations and Levy's maneuvering to protect his interest in becoming prime minister. [] 25X1

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Effects of July 1985 Austerity Measures

The key elements of the austerity program introduced last July were wage and price controls, a 19 percent devaluation followed by a stable exchange rate policy, and a number of deficit reducing measures. The program has worked unexpectedly well with inflation falling from a monthly average of around 14 percent (180 percent per annum) a year ago to 1.5 percent (20 percent per annum) for March. Since July the exchange rate has remained stable at around 1.48 shekels per dollar, while depreciating with the dollar against other currencies. Foreign exchange reserves are now around \$3.0 billion, up about \$500 million from a year ago. [] 25X1

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Austerity has had its costs, however. Unemployment is currently around 7 percent, historically high for Israel, and is expected to grow another 1 percent in the coming months. Real

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wages plunged 18 percent during the last half of 1985 compared to the first half. Personal consumption also fell, but its fall was cushioned as the population benefited from some income tax adjustments and cost-of-living wage and savings increases. Overall, real GNP grew at about 2 percent last year compared to a 0.3 percent fall in 1984. [REDACTED]

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Economic Problems and Outlook

Israel continues to suffer considerable imbalance in its external accounts and is highly dependent upon the United States for balance-of-payment and budget aid. Israel had a civilian goods and services deficit of about \$2.5 billion in 1985 compared to \$3.4 billion for 1984. When military items are included, however, the deficit climbed to \$4.3 billion last year. Israel received total US aid of slightly over \$3.9 billion in 1985 and paid back about \$1.2 billion on past debts. [REDACTED]

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Israel has come a long way in the last year in its fight to straighten out its economy, but it still has a long way to go. The government budget deficit needs to be reduced further in order to consolidate the gains of the austerity program. Upcoming wage negotiations also pose a problem if labor tries to make up a large percentage of the real wages lost last year. Additional issues, such as tax reform and deindexation of the economy, also need to be faced, but are unlikely to be addressed in a meaningful manner before the October Labor-Likud rotation. [REDACTED]

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Israel's Constitutional and Judicial Systems

Israel's system of government is based on an unwieldy combination of basic laws and ad hoc legislation. The first legislative act of Israel's Knesset or parliament in February 1949 was to enact a Transition Law, often referred to as the Small Constitution, which became the foundation of constitutional life in the state. Administrative and executive procedures were based on a combination of past experience in self-government, elements adapted from the former British mandatory structure, and new legislation. According to the Small Constitution, Israel was established as a republic with a weak president and a strong cabinet and parliament. It was anticipated that this document would be replaced in due course by a more extensive and permanent one. [REDACTED]

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Israel's first Knesset was deeply divided between proponents of a written constitution and those who believed that the time was not appropriate for imposing rigid constitutional limitations. The Knesset decided in June 1950 to postpone the issue indefinitely. It agreed in principle that a written constitution would ultimately be adopted, but that for the time being there would be no formal and comprehensive document. Instead, a number of fundamental, or basic, laws would be passed dealing with specific subjects, which might in time form chapters in a consolidated constitution. [REDACTED]

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By the end of 1984 Israel had adopted eight Basic Laws dealing with various issues: The Knesset (1958), The Lands of Israel (1960), The President (1964), The Government (1968), The State Economy (1975), The Army (1976), Jerusalem, The Capital of Israel (1980), and the Judiciary (1984). The Basic Laws provide a definitive perspective of the formal requirements of the system in specific areas of activity. [REDACTED]

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Judicial authority is vested in religious as well as civil courts. The latter include municipal and magistrates' courts for civil and criminal actions, district courts for appeals from the lower tribunals and for matters not triable by a magistrate, and a supreme court. The supreme court, known as the High Court of Justice, cannot review legislation passed by the Knesset, but it has the power to invalidate administrative actions and to interpret statutes it regards as contrary to the rule of law. [REDACTED]

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Each major community in Israel has its own religious courts that deal with matters of personal status. Rabbinical courts

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have exclusive jurisdiction over Jews in marriage and divorce, and they may act on alimony, probate, succession, and other similar questions with the parties' consent. Christian ecclesiastical courts have exclusive authority over Christians in marriage, divorce, alimony, and confirmation of wills, and they may judge other matters if the parties agree. Muslim courts have exclusive jurisdiction for Muslims in all matters of personal status. The judicial appointment procedure seeks to discourage political influence, and judges enjoy tenure subject only to good behavior.

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